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COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

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August 14, 1997

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

VIA FEDERAL EXPRESS


Re: In the Matter of Federal-State Joint Board on Universal Service
CC Docket No. 96-45

Dear Secretary Caton:

In accordance with Paragraph 248 of the Commission's May 8, 1997 Report and Order, the Pennsylvania Public Utility Commission ("PaPUC") hereby notifies the Commission that the PaPUC is electing to conduct its own forward-looking economic cost study for use in calculating federal universal service support for eligible carriers in Pennsylvania. Attached is a copy of the July 31, 1997 Order of the PaPUC which adopts a procedural schedule for completion of state proceedings on this matter. Pursuant to Paragraph 248, the PaPUC will submit its intrastate model to the Commission on or before February 6, 1998.

If you have any questions regarding this letter or the attachment, please contact the Honorable Michael C. Schnierle, Presiding Administrative Law Judge, at (717) 783-5453.

Very yours truly,

K.G. Sophy 

Kathryn G. Sophy
Assistant Counsel

Attachment

cc: Executive Director Bruin
ALJ Schnierle

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PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

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Public Meeting held July 31, 1997

AUG 19 1997

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COMMISSIONERS PRESENT:

John M. Quain, Chairman, Statement attached
Robert K. Bloom, Vice-Chairman
John Hanger
David W. Rolka
Nora Mead Brownell

In re: Formal Investigation to Examine
and Establish Updated Universal Service
Principles and Policies for Telecommunications
Services in the Commonwealth

Docket No. I-00940035

ORDER ON RECONSIDERATION

I. INTRODUCTION

Today, we grant in part and deny in part, the Petitions for Reconsideration of our January 28, 1997 Opinion and Order which tentatively endorsed the BCM-2 as the appropriate method to calculate basic universal service (BUS) costs in Pennsylvania; established the BUS rate level for the purpose of determining BUS funding levels; and established a Universal Telephone Service Task Force to analyze and make recommendations to the Commission on universal service issues in the future. In our Order on Reconsideration, we reopen the record of this proceeding for the purpose of conducting on the record technical workshops to select a final BUS proxy model for Pennsylvania, to determine whether the model selected meets the relevant criteria contained in the FCC's May 8, 1997 Report and Order, and to reach consensus on outstanding issues relating to model parameters and funding mechanism operation.

II. BACKGROUND

This proceeding was commenced by Commission Order dated June 15, 1994. The Order initiated a formal investigation to examine and establish updated universal service principles and policies for basic telecommunications in the

Commonwealth. On April 10, 1995, the Commission entered an Order which bifurcated the investigation into three separate proceedings. The first proceeding consisted of a rulemaking at L-00950102 to establish the parameters for the ongoing evaluation and review of the universal service definition adopted by the Commission.

The second proceeding consisted of a proposed rulemaking at L-00950105 which created a universal service funding mechanism. The Commission's Final Form Rulemaking at this docket was entered on June 21, 1996.

The third proceeding at Docket I-00940035 was an investigation into the cost of providing basic universal service in the Commonwealth. The specific issues to be addressed by the parties included:

(1) application of cost study methodology, the submission of universal cost studies into the record and review of the results of these studies, including evaluation of relevant subsidies, assuming present LEC price levels pertaining to universal service. Analysis of relevant subsidies was to be evaluated both between cost study areas and between basic universal service and other services;

(2) identification of a basic universal service rate and evaluation of hypothetical subsidies between cost study results and the basic universal rate;

(3) identification of rate rebalancing plans by LECs, evaluation of the effect on universal service caused if rebalancing were permitted and identification of hypothetical subsidies which result or remain if rebalancing is presumed relative to both the cost study results and the basic universal service rate. September 5, 1995 at pps. 20-25

The Commission by Order entered October 4, 1995, included access pricing as an additional issue to be addressed in this case. By Secretarial Letter dated October 6, 1995, the Commission asked parties to also address appropriate reciprocal compensation rates.

The Commission subsequently referred the cost issues to the Office of Administrative Law Judge. A prehearing conference was held on September 27, 1995 before Administrative Law Judge Louis Cocheres. Evidentiary hearings were held from March 4, 1996 through March 13, 1996. Parties participating in the evidentiary hearing included the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), the Pennsylvania Telephone

Association ("PTA"), Bell Atlantic-PA, Inc., ("Bell"), GTEN North ("GTEN"), Sprint/United Telephone ("Sprint/United"), ALLTEL Pennsylvania, Inc., the Pennsylvania Cable and Telecommunications Association ("PCTA"), Eastern Telelogic Corporation ("ETC"), AT&T Communications of PA, Inc. ("AT&T"), Teleport Communications Group ("TCG"), MCI Telecommunications, Inc. ("MCI"), and the Office of Trial Staff ("OTS").

The Commission entered its final Opinion and Order at this Docket on January 28, 1997. In its Opinion and Order, the Commission endorsed the use of a forward-looking cost methodology; established a basic universal service rate of \$20.00 for purposes of determining the level of subsidy in high-cost areas of the state; initiated a separate comprehensive generic proceeding on intrastate access charge reform; and established a Universal Telephone Service Task Force, a consortia consisting of interested intergovernmental agencies, industry and trade association representatives and consumer groups. The Commission also initiated a Phase II at this Docket to obtain additional comment on the use of an end-user surcharge to recover universal service contributions.

Petitions for Reconsideration of the Commission's January 28, 1997 Opinion and Order were filed on February 12, 1997 by Sprint/United, MCI, PTA, ALLTEL, GTEN, and Bell. At the request of parties, a technical conference was held on April 28, 1997 for the limited purpose of reviewing and responding to questions on the development of individual company distributions from and contributions into the state universal service funding mechanism contained in Appendix A of the January 28, 1997 Opinion and Order.

Supplemental comments on the data presented at the technical conference and the impact of the FCC's May 8, 1997 Report and Order were filed by parties on May 29, 1997 and reply comments were filed on June 13, 1997. Parties filing Supplemental comments and/or replies included ALLTEL, GTEN, Bell Atlantic, PTA, OCA, AT&T and Sprint/United.

III. DISCUSSION

A. Standard of Review

Consistent with Section 703(g) of the Public Utility Code, 66 Pa. C.S. Section 703(g) of the Public Utility Code, 66 Pa. C.S. Section 703(g), relating to reconsideration, rescission, and amendment of an order, Section 5.572 of our Regulations, 52 Pa. Code Section 5.572, relating to relief following a final decision; and judicial and administrative precedent, the standards for review of a

petition for relief following a final decision are set forth in *Duick v. PG&W*, 56 Pa. P.U.C. 553 (December 17, 1982)(*Duick*).

Duick held that a petition for relief under Section 703(g) of the Public Utility Code may properly raise any matter designed to convince this Commission that we should exercise our discretion to reconsider, rescind, or amend a prior Order, in whole or in part. Such petitions, however, are likely to succeed only when they raise "new and novel arguments" not previously heard or considerations which appear to have been overlooked or not addressed by us. *Duick* at p. 559. The Commonwealth Court case, *AT&T v. Pa. PUC*, 568 A.2d 1362 (Pa. Cmwlth. 1990), further elucidated these standards.

B. Purpose and Need for a State Funding Mechanism

Bell's argument that there is no need for a state funding mechanism fails under the *Duick* standard set out above. Bell argues that Pennsylvania currently has a 97% penetration rate -- one of the highest in the country, and hence, a funding mechanism is not needed. Bell Petition at p. 2. Bell further argues that until rates increase to levels that could cause customers to leave the network, there is no need for a fund to "offset" existing rates. Bell Petition at 2. We have already addressed this issue at length in our January 28, 1997 Opinion and Order. Bell has raised no new arguments in support of its position that we have not already considered and rejected, and thus, *Duick* requires that we reject them. In addition, new circumstances arising since the entry of our January 28, 1997 Opinion and Order strongly support the establishment of a state funding mechanism. Most notably, the FCC's May 8, 1997 Report and Order contemplates the establishment of both federal and state funding mechanisms. Without a state funding mechanism, companies would only receive a partial high-cost offset of 25% from the federal funding mechanism. The other 75% of their costs would not be covered.

We also reject Bell's argument that our January 28, 1997 Opinion and Order is not competitively neutral because it mandates the creation of a fund in which it is the only net contributor. Bell argues that long distance carriers and other providers are either net recipients or are made whole through revenue neutral pass-through of funds and that new CLECs, IXCs and other telecommunications providers escape completely or actually benefit from new subsidies paid by Bell customers. Bell Petition at p. 3. Bell's interpretation is a misreading of our January 28, 1997 Opinion and Order and Appendix A. Not only are all existing telecommunications providers required to contribute to the fund based upon their intrastate operating revenues, but new providers will also begin contributing once

they commence operations in Pennsylvania. There is no doubt that Bell's contributions will initially exceed those of any other providers in Pennsylvania. However, Bell also has 80-90% of the intrastate market at this time and its contributions appropriately reflect this fact. Moreover, it is anticipated that as more competitors enter Bell's markets, Bell's contributions to the funding mechanism will decline proportionately since Bell's competitors will assume the funding obligation to the extent they begin to serve Bell's existing customers. Viewed in this context, the funding mechanism is competitively neutral, and Bell's arguments to the contrary are without merit.

Finally, we also deny GTEN's request for modification of the requirement that monies received from the state Universal Service funding mechanism be reinvested in the network to meet the network modernization objectives of Chapter 30. GTEN asks the Commission to strike this language or clarify that the calculation of the cost of providing Universal Service was not based upon an advanced broadband network -- but rather was calculated based upon the provision of single party, voice grade service and that therefore it is arbitrary and capricious for the Commission to require that Universal Service fund receipts be used for providing services that are not part of Universal Service. GTEN Petition at p. 8. GTEN's primary concern appears to be its belief that the Commission is somehow attempting to tie Universal Service funding or access charge reductions to filing a network modernization and alternative regulation plan under Chapter 30. GTEN Petition at p. 8. GTEN has obviously misconstrued the discussion in our January 28, 1997 Opinion and Order pertaining to the use of fund receipts and Chapter 30. Our Order does not require any company to file a Chapter 30 network modernization and alternative regulation plan as a precondition to receiving state Universal Service funds. Nonetheless, the Commission will require that funds received be used, *inter alia*, to update and modernize the public switched telecommunications network in Pennsylvania. This requirement is consistent with Section 254(e) of the Federal Act, which prescribes that a carrier which receives federal universal service support "shall use that support only for the provision, maintenance and upgrading of facilities and services for which the support is intended." To the extent GTEN believes that Universal Service receipts are not to be used to upgrade the public switched network, we believe that it is interpreting the language of Chapter 30 and the Federal Act too narrowly. GTE's position is clearly inconsistent with both Chapter 30 and the Federal Act and must be rejected.

C. BUS Cost Model and Model Parameters

Bell seeks reconsideration of the BUS cost model endorsed by the Commission in its January 28, 1997 Opinion and Order and numerous ILECs seek

reconsideration of the various model parameters selected by the Commission. Numerous parties commented that the Commission had not allowed comment on the updates to the BCM as contained in the BCM-2 tentatively endorsed by the Commission, and therefore, it was necessary to reopen the record to permit input from the parties on the updated models. Finally, many parties also requested a technical conference with the Commission's consultant¹ to discuss Appendix A to the Commission's January 28, 1997 Opinion and Order which contained estimated individual company contributions to and distributions from the state funding mechanism based on the input parameters adopted by the Commission. In addition, both ALLTEL and GTEN seek reconsideration of our rejection of a company's ability to recover "asset impairment" through the state funding mechanism. We address each of these concerns in turn below, in addition to the need for further refinement given the FCC's May 8, 1997 Report and Order.

1. Use of a Forward-Looking Proxy Model to Determine BUS Costs

Once again, we reject Bell's arguments against the use of a proxy model to determine BUS costs. Bell states that a proxy model is less accurate than studies which measure the actual cost of BUS. Bell Petition at p. 9. Since we have already extensively addressed each of Bell's arguments set forth in its Petition for Reconsideration in our January Opinion and Order, reconsideration is not appropriate under the *Duick* standard discussed above.

Additionally, we note that the FCC, in its May 8, 1997 Report and Order, has itself endorsed the use of forward-looking economic costs for the purpose of sizing the federal universal service support mechanism.² We recognize that this Commission, like the FCC, needs to do more work before it can select a permanent model to determine BUS costs. We are confident that this work can be completed quickly, and in time to submit the results to the FCC by the deadline of February 6, 1997, contained in its May 8, 1997 Report and Order.

Indeed, almost all commenting parties recommend that the Commission notify the FCC that it would like to use its own intrastate costing model to determine state funding levels under the federal mechanism. We agree. Given the significant work Pennsylvania has already done to develop a costing model of its

¹ The Commission hired an independent consultant to assist the Staff in analyzing the cost studies submitted in this proceeding.

² See, *In the Matter of the Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order (May 8, 1997), at para. 232.

own to determine BUS costs, we should not abandon our efforts at this juncture. In particular, our already considerable efforts in Pennsylvania may be instructive to the FCC in selecting a model for the federal funding mechanism. The FCC has stated that it hopes to draw on the work now underway in various states to fashion to some extent its own model for federal funding purposes. The FCC's recent May 8, 1997 Report and Order requires that a state notify it by August 15, 1997 if it intends to submit its own cost study for federal funding purposes. Accordingly, as most parties to this proceeding urge, this Commission will file such an election with the FCC on or before August 15, 1997, and forward a copy of this Opinion and Order to the FCC in order for the agency to closely track developments in our state proceeding.

The FCC has stated in its Universal Service Order that a state cost study will receive FCC approval for federal funding purposes only if it meets proof of the following ten criteria:

1. The technology assumed in the cost study or model must be the least-cost, most-efficient, and reasonable technology for providing the supported services that is currently being deployed. A model, however, must include the ILECs' wire centers as the center of the loop network and the outside plant should terminate at ILECs' current wire centers. The loop design incorporated into a forward-looking economic cost study or model should not impede the provision of advanced services. For example, loading coils should not be used because they impede the provision of advanced services. We note that the use of loading coils is inconsistent with the Rural Utilities Services guidelines for network deployment by its borrowers. Wire center line counts should equal actual ILEC wire center line counts, and the study's or model's average loop length should reflect the incumbent carrier's actual average loop length.
2. Any network function or element, such as loop, switching, transport, or signaling, necessary to produce supported services must have an associated cost.
3. Only long-run forward-looking economic cost may be included. The long-run period used must be a period long enough that all costs may be treated as variable and avoidable. The costs must not be the embedded cost of the facilities,

functions or elements. The study or model, however, must be based upon an examination of the current cost of purchasing facilities and equipment such as switches and digital loop carriers (rather than list prices).

4. The rate of return must be either the authorized federal rate of return on interstate services, currently 11.25 percent, or the state's prescribed rate of return for intrastate services. We conclude that the current federal rate of return is a reasonable rate of return by which to determine forward looking costs. We realize that, with the passage of the 1996 Act, the level of local service competition may increase, and that this competition might increase the ILECs' cost of capital. There are other factors, however, that may mitigate or offset any potential increase in the cost of capital associated with additional competition. For example, until facilities-based competition occurs, the impact of competition on the ILEC's risks associated with the supported services will be minimal because the ILEC's facilities will still be used by competitors using either resale or purchasing access to the ILEC's unbundled network elements. In addition, the cost of debt has decreased since we last set the authorized rate of return. The reduction in the cost of borrowing caused the Common Carrier Bureau to institute a preliminary inquiry as to whether the currently authorized federal rate of return is too high, given the current marketplace cost of equity and debt. We will re-evaluate the cost of capital as needed to ensure that it accurately reflects the market situation for carriers.
5. Economic lives and future net salvage percentages used in calculating depreciation expense must be within the FCC-authorized range. We agree with those commentaries that argue that currently authorized lives should be used because the assets used to provide universal service in rural, insular, and high cost areas are unlikely to face serious competitive threat in the near term. To the extent that competition in the local exchange market changes the economic lives of the plant required to provide universal service, we will re-evaluate our authorized depreciation schedules. We intend shortly to issue a notice of proposed rule making to further examine the Commission's [FCC's] depreciation rules.
6. The cost study or model must estimate the cost of providing service for all businesses and households within a geographic

region. This includes the provision of multi-line business services, special access, private lines, and multiple residential lines. Such inclusion of multi-line business service and multiple residential lines will permit the cost study or model to reflect the economies of scale associated with the provision of these services.

7. A reasonable allocation of joint and common costs must be assigned to the cost of supported services. This allocation will ensure that the forward-looking economic cost does not include an unreasonable share of the joint and common costs for non-supported services.
8. The cost study or model and all underlying data, formulae, computations, and software associated with the model must be available to all interested parties for review and comment. All underlying data should be verifiable, engineering assumptions reasonable, and outputs plausible.
9. The cost study or model must include the capability to examine and modify the critical assumptions and engineering principles. These assumptions and principles include, but are not limited to, the cost of capital, depreciation rates, fill factors, input costs, overhead adjustments, retail costs, structure sharing percentages, fiber-copper cross-over points, and terrain factors.
10. The cost study or model must deaverage support calculations to the wire center serving area level at least, and, if feasible, to even smaller areas such as a Census Block Group, Census Block, or grid cell. We agree with the Joint Board's recommendation that support areas should be smaller than the carrier's service area in order to target efficiently universal service support. Although we agree with the majority of the commenters that smaller support areas better target support, we are concerned that it becomes progressively more difficult to determine accurately where customers are located as the support areas grow smaller. As SBC notes, carriers currently keep records of the number of lines served at each wire center, but do not know which lines are associated with a particular CBG, CB, or grid cell. Carriers, however, would be required to provide verification of customer location when they request

support funds from the administrator. FCC Universal Service Order, ¶ 250 (footnotes omitted).

It will be necessary for Pennsylvania to examine whether the model which we ultimately select as a permanent BUS costing model meets these ten criteria. As discussed below, we ask parties to address whether these ten criteria will be satisfied by the proposed final BUS cost model, in the on the record workshops that will commence next month.

2. Model Inputs

We do not find merit in the arguments of numerous ILECs that the Commission should use company specific inputs in its proxy model to determine BUS costs. For instance, several companies continue to argue that the prices of capital goods, materials and labor have a direct and critical effect on cost estimates, and hence, the values used need to be regional and company specific and not national averages. See, *inter alia*, GTEN Petition at p. 4.

GTEN also criticizes the Commission's Opinion and Order for allegedly failing to utilize a forward-looking annual charge factor which uses forward-looking capital costs, rates of return, and debt/equity ratios. GTEN Petition at 3. GTEN argues that competition in the industry will increase risks; therefore, forward-looking capital costs are higher than current capital costs. Petition at 3. GTEN also argues that forward-looking debt/equity ratios are lower than today's actual ratios and forward-looking depreciation lives are considerably shorter than the book depreciation lives which have been determined by regulatory decision. Petition at p. 3. GTEN also argues that the Commission's Order fails to recognize the joint and common costs incurred by companies. GTEN Petition at p. 12. Finally, it is GTEN's position that the failure to utilize a company's actual costs raises serious constitutional questions. GTEN Petition at p. 12.

ALLTEL and PTA also support the use of company-specific information with regard to annual carrying charges, equipment purchase discounts, and other inputs. ALLTEL Petition at p. 13; PTA Petition at p. 7. PTA argues that the Order allows companies with less than 50,000 access lines to use a loading factor of only 28% as opposed to the approximately 30-35% range demonstrated by the PTA. PTA argues that the 28% annual carrying factor for the smaller companies was derived by the Commission without record support, by simply pro-rata factoring of the two theoretic methods of TS-LRIC costing (BCM and Hatfield) and ignores the uncontested record evidence presented by the PTA. PTA Petition at p. 7.

Because we believe that forward-looking data is more competitively neutral and appropriate for use in determining BUS costs, we once again reject the use of company-specific inputs. No party has presented any new arguments that have not already been considered and rejected by the Commission in its January 28, 1997 Opinion and Order, and accordingly *Duick* also requires their rejection.

We note, however, that the updated BUS cost model information may contain parameters and/or inputs that differ from those specified in our January 28, 1997 Opinion and Order. We specifically request parties to comment on the differences in the on the record workshops to commence in August. In addition, we note that the ten criteria specified by the FCC may require reexamination of some of the parameters and/or inputs adopted in our January 28, 1997 Opinion and Order; including capital costs and rate of return. We have already stated that parties are to address these issues in the technical workshops. Consequently, while we deny reconsideration on the use of company specific inputs, further consideration of certain parameters and/or inputs adopted in our January 28, 1997 Opinion and Order is not altogether foreclosed.

Finally, we find merit to the arguments of both Sprint and ALLTEL that we structure our state funding mechanism similar to the federal funding mechanism and recognize the distinction between rural and non-rural carriers, rather the looking at the number of access lines as Chapter 30 does. As discussed later, we agree with ALLTEL and Sprint that the distinction between rural and non-rural carriers more closely reflects the intent of Section 254 of the Federal Act. Therefore, like the FCC, we find that this distinction is appropriate for purposes of study parameters and/or inputs which would permit us to take into account the unique circumstances of smaller, rural carriers.

3. Asset Impairment

We deny reconsideration of our determination that recovery for asset impairment be accomplished outside of the state funding mechanism. Both GTEN and ALLTEL seek reconsideration of their ability to recover for asset impairment. ALLTEL Petition at p. 14. ALLTEL argues that in every other fixed utility service that has moved to competition, the Commission and its federal counterparts have provided some mechanism for recovery of stranded investment or transition costs. ALLTEL Petition at p. 15. ALLTEL also states that in the recently enacted Chapter 28, the Commission and the Legislature worked diligently to assure that electric utilities would be provided an opportunity to recover, through a competitive transition charge assessed each customer using the distribution or

transmission system, transition costs incurred and stranded costs arising during the transition to electric generation competition. ALLTEL further argues that the Commission provided the gas industry a means of recovering FERC Order 636 transition costs when the gas industry moved toward deregulation. ALLTEL Petition at p. 16.

We do not dispute that stranded costs may ultimately become an issue in the telephone industry as it has in other industries. We see several problems with the position of both ALLTEL and GTEN, however, that stranded costs be recovered as part of the state universal service funding mechanism. First, these costs are speculative at this time -- no credible evidence has been presented by any party that stranded costs exist or that they will ever materialize. Second, Chapter 28 explicitly provides for the recovery of stranded costs; Chapter 30 does not. Finally, the FCC has not yet recognized stranded costs as appropriate for recoupment as part of the federal funding mechanism. We also reiterate that recovery of stranded costs is more appropriately addressed within the context of a Section 1308 proceeding than within the context of this proceeding, and accordingly, we once again reject the arguments of ALLTEL and GTEN with regard to the inclusion of stranded costs in the state universal service funding mechanism.

D. Loop Allocation

While the arguments of the parties seeking reconsideration on the allocation of the local loop have for the most part been considered and rejected by this Commission, subsequent events including the FCC's findings in its May 8, 1997 Report and Order require that we reexamine this issue. GTEN argues that the Commission's arbitrary allocation of loop costs is inconsistent with the FCC's First Report and Order in FCC CC Docket No. 96-98, released August 8, 1997. The loop, argues GTEN, is a critical element to which the FCC allocates common costs, not the other way around. GTEN Petition at p. 5. GTEN also recommends that the Commission defer its final decision on loop allocation until the FCC has issued its orders on access charge reform and universal service so that there is consistency between the way the loop is treated as a cost and the way the cost of the loop is recovered. GTEN Petition at p. 6.

While as already noted we do not find the majority of arguments presented persuasive and note that many of them have already been considered and rejected by this Commission in its January 28, 1997 Opinion and Order, we do agree that a degree of consistency between our funding mechanism and the mechanism adopted by the FCC is desirable. The Pennsylvania costing method allocates loop

cost based on SLU, whereas the FCC mechanism does not. GTEN Supplemental Petition at p. 10.

The differences between the FCC's approach and our approach in this respect were also pointed out by the OCA which noted that the Commission has calculated universal service funds by setting a BUS rate, allocating loop costs to BUS and then comparing the BUS cost to the BUS rate; but that the FCC has calculated BUS costs using a very different approach. OCA Supplemental Petition at p. 9.³ OCA states that the FCC has used a benchmark of revenue per line for a group of services including local, discretionary and interstate and intrastate access services. OCA Supplemental Petition at p. 8. OCA advocates that the Commission consider modifying some of its cost determination requirements in order to be consistent with the FCC's Universal Service Order.

We agree that it is important that the federal and state funding mechanisms be consistent in this respect so that distributions under both do not result in either under-funding or over-funding of BUS in high cost areas. While we continue to believe that the loop is a joint cost which should be allocated among the services that utilize it, we believe that consistency in this regard with the approach taken by the FCC in its May 8, 1997 Report and Order is critical. We are also willing to modify our position because we believe that the approach taken by the FCC takes full account of the contributions made by other services by taking into account the revenues received from all of those services in determining BUS funding levels.

We also note that as GTEN pointed out, the interim SLU of 74% used in the universal service order is close to the 75%/25% split ordered by the FCC. However, the application of those ratios results in significantly different results. The FCC applies the 25% allocator to the difference between the cost and the revenue benchmark, while under our funding mechanism, the allocator is applied to the costing end of the equation only.

We, therefore, modify our January 28, 1997 Opinion and Order to adopt the FCC's approach which examines total costs and revenues. Consistency will ensure that carriers do not receive a windfall or in the alternative are under-funded. Important to our decision to reconsider is the fact that all parties filing comments agree that it is important that the state funding mechanism be consistent with the federal funding mechanism in this regard. See, Supplemental Petition of the OCA, at pps 8-9.

³ Accord, PTA Supplemental Petition at p. 8.

Without modification, if the Commission were to change its benchmark to be consistent with the FCC calculation, as we do below, it would be double-counting the implicit subsidies, if the loop was allocated based upon SLU, because costs would be decreased (via the allocation of the loop based on SLU) and revenues would be increased to account for revenues from other services. GTEN Supplemental Petition at p. 10.

E. BUS Rate

Our Final-Form Rulemaking at Docket L-00950105 provided for the establishment of a BUS rate to be used to determine state funding levels. The FCC's May 8, 1997 Report and Order utilizes a revenue benchmark which is applied against BUS costs to determine funding levels. Several parties seek reconsideration of the \$20.00 BUS rate selected by the Commission to determine BUS funding levels, as well as the overall approach taken by the Commission in light of the FCC's Report and Order.

With regard to the rate itself, Bell argues that the fund should not authorize the subsidization of rates that are already affordable. Bell Petition at p. 4. Bell states that only two LECs in Pennsylvania charge a higher price for BUS than the Commission-determined maximum rate of \$20 per month, and thus, Bell states that the Commission's Order may perversely provide funds to high-cost companies even when those companies actually have lower rates than lower cost companies like Bell. Bell Petition at p. 5.

GTEN argues that both contributions to and receipts from the Universal Service fund are based upon an incorrect assumption that the local exchange carrier is charging a BUS rate of \$20. This results in a requirement that the LEC "fund" the difference between the rate it charges and the \$20 BUS rate wherever the BUS cost is higher than the current rate charged. This will necessitate the continuation of an implicit subsidy. GTEN Petition at p. 9. Sprint agrees that companies with basic service rates below the regulated price of basic service must be allowed to bring their prices up to that rate to eliminate as much implicit subsidy as possible. In that way the dollars that need to be drawn from the fund are lessened and the total USF is sized correctly. Sprint Petition at p. 8

GTEN and Sprint also argue that since the Commission requires an eligible carrier to show the monthly credit associated with their service area, on customers' bills, a correct result can only be reached if the eligible carrier is authorized to show on the customer's bill the full cost of serving the area in question. GTEN Petition at p. 10. Sprint also argues that to design a billing system to "show"

customers a credit on their bills, which is unrelated to the price of their service, would be an administrative nightmare. Sprint Petition at p. 3.

Many parties filed Supplemental Petitions discussing, *inter alia*, the impact of the FCC's May 8, 1997 Report and Order upon the BUS rate adopted by the Commission. Most parties agree that consistency between the FCC and Pennsylvania approach would be desirable. PTA notes that the FCC suggests a benchmark rate of \$31 for residential service and \$51 for business customers. These benchmark rates include revenues associated with subscriber line charge, inter and intralata CCL, intralata toll, vertical services and basic service. PTA Supplemental Petition at p. 8. OCA argues that since the FCC will fund a 25% portion of high cost support, it would be appropriate for the Commission to use an approach similar to the FCC's, so as to avoid over or under-funding. OCA Supplemental Petition at p. 9.

We note to begin with that the BUS rate has been the subject of much confusion and misunderstanding, and continues to be. While we have repeatedly stated that the sole purpose of the BUS rate is to determine BUS funding levels, parties continue to attribute far more significance to it than ever was intended by this Commission. Many parties continue to believe that it constitutes a "cap" on the rates that may be charged by eligible carriers. Other parties continue to believe that before a carrier may become eligible for high-cost support, it must charge a rate higher than the BUS rate selected by the Commission. Still others believe that all ILECs must be permitted to rate rebalance up to the BUS rate, or implicit subsidies will result.

All of these positions belie a fundamental misunderstanding of the BUS rate's purpose and function. The BUS rate was never intended to function as a cap on the rates that could be charged by eligible carriers. Nothing in the Federal Act would support this Commission imposing an additional requirement in the form of a "rate cap" on a carrier's eligibility for federal funds. Additionally, the Commission at Docket L-00950105 has adopted the same eligibility criteria set out in the Federal Act for purposes of the state funding mechanism. Nor did we ever intend that the BUS rate be used as a form of endorsement by this Commission of rate rebalancing up to the BUS rate level selected, as other parties appear to believe. Carrying this position to its logical conclusion, all Pennsylvania consumers would end up paying the same rate for local service regardless of the location they lived or the carrier that served them. Such an approach would fly in the face of effective competition.

We also note, in response to the further concerns of GTEN and Sprint that this Commission has never mandated that the actual credit appear on the customer's bill. See Final-Form Rulemaking Order at Docket L-00950105 at pps. 59-60. The Commission's January 28, 1997 Opinion and Order did nothing to change this result.

Nonetheless, given all of the confusion and concern that continues to surround the BUS rate, and the fact that we believe consistency in calculating funding levels between the state and federal models is important to prevent over or under-funding, we tentatively modify our January 28, 1997 Opinion and Order and adopt the use of a revenue benchmark for the purpose of determining Universal Service funding levels. This approach is consistent with the approach taken by the FCC, and therefore, should simplify administration of the state funding mechanism. This approach will also eliminate much of the confusion and misunderstanding that presently surrounds the BUS rate. It is our intent initially to use the same revenue benchmark ultimately selected by the FCC. Nonetheless, we ask parties to comment on the appropriate level of the benchmark, including the use of individual company benchmarks or state average benchmarks, when the record in this proceeding is reopened as discussed in Section G following.

F. Technical Conference and Calculation of Net Distributions and Contributions

1. Cost Calculation

Sprint states that there are two major errors in the calculations appearing in Appendix A to the Commission's January 28, 1997 Opinion and Order.⁴ First, Sprint argues that the calculations incorrectly apply the subscriber line usage ("SLU") allocation of 74% for large local exchange and 90% for small LECs to the total cost of universal service. Sprint Supplemental Petition at p. 3. In addition, according to Bell, this has a greater proportionate impact on large LECs because of the lower allocation factor used for the larger carriers. Bell Supplemental Petition at p. 7.

Second, Sprint notes that the BCM-2 applies three different and distinct annual charge factors (ACFs) to three classes of plant: 23.28% for Cable and Wire, 24.24% for Circuit, and 25.7% for Switching. Additionally, the non-plant

⁴ Several ILECs agree with Sprint that the loop allocation factors should not have been applied to total loop and switch investment. See GTEN Supplemental Petition at p. 3; PTA Supplemental Petition at pps. 4-5.

related expenses are a BCM-2 constant amount added to each access line. Sprint Supplemental Petition at p. 9. Sprint states that the total effect for United in correcting the application of the 22.9% ACF is an increase in annual subsidy.⁵

Although we agree that both of these criticisms have technical merit, it should be recognized that this Commission, its consultant and its staff have been operating under certain constraints while preparing the BUS cost and USF support estimates that were contained in Appendix A of our January 28, 1997, Order in the instant Docket. These constraints include but are not limited to: (1) ease of access to the BCM-2 cost model and associated data bases that the model utilizes; (2) the ability to independently work with the model in order to produce alternative model runs with changes in the input assumptions; and (3) the need to protect the Commission's confidentiality and privilege of its own deliberative process. Thus, in view of the time constraints imposed by our own deliberative process, the Commission's consultant had to almost exclusively rely on manipulating the BCM-2 model outputs in order to reflect the BUS cost and USF support parameters that were established in our January 28, 1997 Opinion and Order. This approach, however, was hampered by the fact that the available BCM-2 model outputs did not distinguish in sufficient detail the discrete amounts of capital investment in various categories of telephone plant. The fact that the BCM-2 model run outputs did not sufficiently distinguish between the capital investment amounts in non-traffic sensitive (NTS) loop plant and the NTS portion of central office (CO) switching equipment, complicated the efforts of the Commission's consultant in producing BUS cost and USF support estimates that would have reflected the intent of the Commission's Order with the requisite degree of precision.

We reiterate that the initial estimates of USF costs and funding support requirements that were included as Appendix A to our January 28, 1997 Opinion and Order, were only estimates. The Commission has always recognized that a true-up process would be necessary and that once a permanent model was selected by the Commission, new runs would have to be completed. Appendix A was merely to give parties an idea of the cumulative impact of the various parameters selected by the Commission on funding size and individual company distributions and contributions.

We also note that certain of the criticisms may have already been superseded by later developments. Namely, enhanced versions of the costing models that are

⁵ Several ILECs agree with Sprint that the Commission's consultant did not apply the annual carrying charge factors specific to the BCM-2 model. See Bell Supplemental Petition at pps. 10-11; GTEN Supplemental Petition at p. 3.

designed to measure the BUS costs and USF requirements are available or will be made available in the near future. As certain comments that have been filed by the parties in the context of the Reconsideration Petitions also suggest, there is also a larger need for coordinating this Commission's Universal Service proceeding and activities in the instant Docket with the corresponding proceedings before the FCC.

While we note Bell's further concern that Dr. Stevenson may not have applied the common cost factor because he assumed common costs were already included in the costs provided to him, the record is simply not sufficiently developed on this point to make any determination on whether Dr. Stevenson's calculations in this regard were technically correct. For instance, we note that the computational logic of certain proxy cost models already accounts for certain common costs. For example, as United/Sprint's Supplemental Comments clearly indicate, certain common costs were accounted as part of the ACF in the original BCM model. United Supplemental Comments at 7, also citing Technical Conference Tr. at 2099-2104. This has already been addressed by our Order where we observed that the BCM's use of a 22.97% ACF is based on certain assumptions including "General and Administrative expenses that are based on a 10% Gross-Up level for Overhead." *Order* at 50, citing Sprint/United St. 2.0 at 28-30 (Dunbar). Furthermore, the same Order pointed out that the BCM assumptions regarding CO switching technologies include a certain "common cost per switch [of] \$647,526" which translates to a "per line cost [of] \$238.87." *Order* at 49, citing Sprint/United St. 2.0 at 28 (Dunbar). As the United/Sprint Supplemental Comments point out there are certain differences on how the original BCM model and its BCM-2 version account for common costs (non-plant related expense add-ons). United Supplemental Comments at 7. Nonetheless, it appears, however, that the United/Sprint proposed corrections to Appendix A of the January 28, 1997 Opinion and Order, may account for common costs (non-plant related expense add-ons) through an allocation of a non-plant related expense add-on which is allocated between the loop and the switch. United Supplemental Comments at 7-8. Consequently, given the uncertainty surrounding this issue, we direct parties to reexamine this issue in the technical workshops discussed in Section G.

In addition, the other concern raised by parties in the Technical Conference and their Supplemental Petitions relating to a discrepancy in the number of households used by the Commission's consultant, should also be resolved in the on the record workshops to be conducted by the Commission, discussed in Section G below.

In summary, the need for more precise derivation of the Pennsylvania-specific BUS costs and USF support is obvious given the concerns raised by the

parties at the Technical Conference and more recent developments including continued enhancements to the BUS costing models and the subsequent findings of the FCC in its May 8, 1997 Report and Order on Universal Service.

2. Revenue Calculation

Many parties argue that the calculations and assumptions for LEC revenues available for USF support are flawed and in need of revision. For instance, both Bell and Sprint argue that uncollectible revenues are being added back to gross intrastate operating revenues to arrive at net operating revenues when they should be subtracted from gross revenues to arrive at net revenues. Sprint Supplemental Petition at p. 12; Bell Supplemental Petition at p. 13. Sprint and Bell also argue that it is inappropriate to add directory and other non-regulated revenues to operating revenues (either net or gross) to arrive at something titled total regulated revenue. Both companies argue that non-regulated revenues should not be utilized as part of the basis on which the commission computes individual company contributions. Sprint Supplemental Petition at p. 13. Bell argues that nothing in the January 28, 1997 Opinion and Order permits consideration of revenues that are not derived from the provision of intrastate telecommunications services in calculating carriers' USF contributions. Bell Supplemental Petition at p. 13. GTEN states that the total intrastate revenues numbers for all carriers in Pennsylvania are only an estimate and must be closely scrutinized by industry participants before actual company contributions are made. GTEN Supplemental Petition at p. 6.

Finally, according to Bell, the revenues attributed to non-wireline carriers were based on an estimate that understates the revenues actually being earned by those carriers. Bell Supplemental Petition at p. 13. All in all, GTEN states that the total intrastate revenues numbers for all carriers in Pennsylvania are only an estimate and must be closely scrutinized by industry participants before actual company contributions are made. GTEN Supplemental Petition at p. 6.

We agree with parties that CMRS intrastate revenues were likely understated in Appendix A. CMRS providers are not subject to entry or rate regulation by the Commission and are not currently under any reporting obligations to this agency. The Staff estimate, therefore, had to rely exclusively on 1994 revenue figures supplied by the FCC for CMRS providers that were unequivocally known to operate in Pennsylvania, i.e., those providers that had Pennsylvania business addresses. The Staff also utilized a very conservative 15% annual growth figure for the 1994-1995 period in order to adjust the intrastate revenue estimate for the CMRS providers to a

1995 level.⁶ As such, the intrastate CMRS revenue estimate included in Appendix A can only be characterized as a preliminary baseline estimate. Once again, this was an estimate used to give parties a preliminary idea of the level of funding required given the parameters selected by the Commission in its January 28, 1997 Opinion and Order. This estimate must be updated and trued up once a final BUS model is selected by the Commission and the funding mechanism. Nonetheless, we ask parties to address these issues in more detail in the on the record technical workshops to be conducted by the Commission commencing next month.

With respect to the other concerns raised regarding inclusion of uncollectibles, directory revenues and unregulated revenues of ILECs, in identifying the revenue pool that can be used for USF contributions, we note that in our USF rulemaking at Docket No. L-00950105, the Commission identified the sources for USF contributions as "gross intrastate operating revenues" which, by definition, include uncollectible revenues and other nonregulated revenues. If the Commission accepted the arguments of parties that the categories of available funding sources for USF contribution purposes should be restricted to intrastate regulated revenues alone, computation of these revenues would be always at issue. The verification of the revenue levels for individual telecommunications carriers would also become increasingly difficult if this agency and its Staff were to engage in complex computations in order to ascertain the revenues of each telecommunications carrier that are subject to USF contributions. Such information should be readily and easily available and verifiable through existing reporting requirements with this Commission.

We also note that certain revenue categories are not per se deregulated for all telecommunications carriers that will be subjected to USF contributions. For example, although this Commission does not regulate telephone company directory operations, directory revenues are accounted as being "below the line" only for certain companies that have been accorded alternative or streamlined regulatory treatment under Chapter 30. See generally *Bell Atlantic-Pennsylvania, Inc.*, Docket No. P-00930715, Order entered June 28, 1994. However, the directory operations and the associated revenue stream arises from the overall telecommunications operations that telephone companies in general and ILECs in particular are engaged. Therefore, we believe that their inclusion is appropriate.

⁶The staff information denoted that the 1993-1994 total revenue growth for readily identifiable CMRS operating in Pennsylvania was 16.04%. The number of CMRS firms increased from 27 in 1993 to 34 in 1994, or by 25.93%.

G. Due Process Concerns and Reopening the Record

Most parties urge the Commission to reopen the record of this proceeding to permit further evidence to be submitted on the BUS costing model tentatively endorsed by the Commission and on the updates and improvements to the model. For instance, Bell argues that the BCM-2 was introduced after the record was initially closed and the hearings concluded, and the parties have had no meaningful opportunity to conduct discovery, cross examine the sponsors, or prepare and submit responsive evidence. Bell also states that there are significant conceptual flaws with the BCM-2 model and that it has now been superseded by another model called the BCPM. Bell goes on to state that the FCC identified several aspects of the BCPM which prevented its use to calculate BUS costs at the federal level. Bell Supplemental Petition at p. 17.

Bell further argues that the FCC's findings, although not automatically binding on the Commission for purposes of determining state funding levels, raise significant questions with respect to the Commission's tentative adoption of the BCM-2 model together with certain adjustments and assumptions. Bell Supplemental Petition at p. 17. Bell states that these considerations militate in favor of re-opening the record for the limited purpose of determining whether the FCC's findings merit adjustment of the Commission's determinations. Bell Supplemental Petition at p. 17

Most other parties agree that the Commission should reopen the record to allow after-discovered evidence, the BCPM, to be placed on the record and examined by the parties in the proceeding. Such examination would proceed after the BCPM is updated in accordance with the FCC's recently released USF cost model criteria. Sprint recently stated that the BCPM updated information would be available in mid-August. Sprint Supplemental Petition at p. 2. GTEN states that the Commission should through the Phase II costing workshops, develop a cost study for filing with the FCC on or before February 6, 1998. GTEN Supplemental Petition at p. 9.

GTEN advocates that the review include not only the models' structures, that is, algorithms and internal relationships, but also the justification of key parameter values such as fill factors and other user-variable inputs such as materials prices and discounts. GTEN Petition at 3. GTEN notes that models are highly sensitive to key parameter values, such as fill factors, capital costs, depreciation lives and structure sharing factors. The degree of sensitivity has to be

established by extensive testing and then the values of any parameters to which the model is sensitive have to be carefully chosen. GTEN Petition at p. 4.

GTEN also proposes that industry participants work through the details of the funding and contribution calculations. GTEN Supplemental Petition at p. 7. This would allow for a complete understanding within the industry of how funding and contributions are determined, and more importantly, produce more accurate results. GTEN Supplemental Petition at p. 7.

At least one party, however, argues that the formal reopening of the record will lead to unnecessary litigation and delay, and that this approach is not the most constructive method for resolving the BUS cost model issue. AT&T Supplemental Reply Comments at 6-7, citing Supplement to Petition for Reconsideration and Clarification of Bell Atlantic-Pa., at 17-18. Both arguments have merit from a substantive and procedural viewpoint, and accordingly we attempt to accommodate both to the extent possible. It is clear that the record of this proceeding must be reopened to examine updated information on the models and the findings of the FCC in its May 8, 1997 Report and Order. Nonetheless, at the same time we believe that the reduction of formal litigation is desirable and that to the extent consensus can be achieved on the various issues, it is far more likely to be accomplished in the context of a nonadversarial proceeding. To accomplish both the objective of permitting additional record evidence on the issues outlined herein and below, while at the same time encouraging consensus building to the extent possible, we will order the following. We shall direct the reopening of the formal evidentiary record in the instant proceeding. We shall further direct the Office of the Administrative Law Judge to preside over a series of technical on the record workshops on the Universal Service cost proxy models. These workshops shall be open to the public. We further direct the Office of the Administrative Law Judge to coordinate the conduct of these workshops with the members of the Universal Service Task Force as well as with other offices of the Commission as it may be deemed necessary. The purposes of the technical workshops will be to elicit the necessary information that will enable the Commission to select a proxy cost model for the estimation of BUS costs and of USF support in Pennsylvania, as well as an examination of an appropriate benchmark for use in determining BUS funding levels.

The information presented in these workshops shall include but may not be limited to:

1. The presentation of the most up-to-date proxy cost models and/or enhanced versions of those models previously considered in the evidentiary record in the instant proceeding.

2. Whether the presented cost proxy models meet the criteria discussed in our January 28, 1997 Opinion and Order, as well as the criteria set forth in the FCC's Universal Service Order of May 8, 1997.
3. The computational logic and fundamental input assumptions utilized by the proxy cost models.
4. Alternative model runs with changes in the input assumptions, where such changes, singly or in combination, shall reflect not only the input assumptions adopted in our January 28, 1997 Opinion and Order, but also the tentative assumptions reached herein and such other reasonable assumptions as they may be necessary in order to coordinate Pennsylvania's BUS cost and US support estimation with the FCC's Universal Service Order of May 8, 1997, and any other Universal Service support activities that are being carried out on the federal level.
5. The alternative model runs should include the corresponding Pennsylvania-specific US support results that should be generally depicted in the same format as in Appendix A of our January 28, 1997, Order.
6. Any other issue as appropriate given our findings herein.
7. The participating parties should also present their proposals on:
 - How the Commission can utilize any and all of these models in the deliberative stage of the proceedings in the instant Docket, while preserving the due process rights of the participating parties and the confidentiality and privilege of the Commission's own decision making process.
 - How the Commission can utilize the selected cost proxy model for the development of its own Universal Service cost studies for submission to the FCC in accordance with the FCC's May 8, 1997, Universal Service Order.

At the conclusion of the workshops, parties shall be given an opportunity to submit their final positions in the form of initial and reply briefs.

While we do not normally do so, given the constricted timeframe imposed by the FCC's May 8, 1997 Report and Order for the submission of state cost studies, we find it necessary to establish a procedural schedule at the outset of this case. Accordingly, we direct the Office of Administrative Law Judge to adhere to the following procedural schedule to the extent possible. Pursuant to the schedule set out below, we request parties to initially address the procedural issues raised in item 7 above, and any other matters of a procedural nature, which will be the subject of a separate interim Report and Recommendation to be submitted by the presiding ALJ in this case.

Initial prehearing Conference	Within 10 days of the entry date of this Order
Comments on procedural issues raised in item 7 above	August 27, 1997
Reply comments on procedural issues	September 10, 1997
Technical workshops	August 15, 1997 through October 15, 1997
Interim Report and Recommendation on procedural issues	October 10, 1997
Initial Brief due	October 30, 1997
Reply Briefs due	November 14, 1997
Report and Recommendation to the Commission	December 15, 1997
Exceptions to Report and Recommendation due	December 30, 1997
Replies to Exceptions due	January 9, 1997

The presiding ALJ shall have discretion to waive or alter any of the above dates to the extent necessary with the exception of the date for commencement of this proceeding and for submission of a final Report and Recommendation to the Commission.